

Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended and P.A. 71 of 1919, as amended.

Local Unit of Government Type <input type="checkbox"/> County <input type="checkbox"/> City <input type="checkbox"/> Twp <input checked="" type="checkbox"/> Village <input type="checkbox"/> Other		Local Unit Name Village of Three Oaks	County Berrien
Fiscal Year End 02/28/2006	Opinion Date 05/04/2006	Date Audit Report Submitted to State 11/14/06	

We affirm that:

We are certified public accountants licensed to practice in Michigan.

We further affirm the following material, "no" responses have been disclosed in the financial statements, including the notes, or in the Management Letter (report of comments and recommendations).

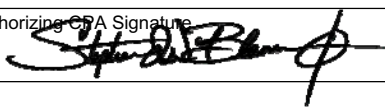
YES
NO

Check each applicable box below. (See instructions for further detail.)

1. ☒ ☐ All required component units/funds/agencies of the local unit are included in the financial statements and/or disclosed in the reporting entity notes to the financial statements as necessary.
2. ☐ ☒ There are no accumulated deficits in one or more of this unit's unreserved fund balances/unrestricted net assets (P.A. 275 of 1980) or the local unit has not exceeded its budget for expenditures.
3. ☒ ☐ The local unit is in compliance with the Uniform Chart of Accounts issued by the Department of Treasury.
4. ☒ ☐ The local unit has adopted a budget for all required funds.
5. ☒ ☐ A public hearing on the budget was held in accordance with State statute.
6. ☒ ☐ The local unit has not violated the Municipal Finance Act, an order issued under the Emergency Municipal Loan Act, or other guidance as issued by the Local Audit and Finance Division.
7. ☒ ☐ The local unit has not been delinquent in distributing tax revenues that were collected for another taxing unit.
8. ☒ ☐ The local unit only holds deposits/investments that comply with statutory requirements.
9. ☒ ☐ The local unit has no illegal or unauthorized expenditures that came to our attention as defined in the *Bulletin for Audits of Local Units of Government in Michigan*, as revised (see Appendix H of Bulletin).
10. ☒ ☐ There are no indications of defalcation, fraud or embezzlement, which came to our attention during the course of our audit that have not been previously communicated to the Local Audit and Finance Division (LAFD). If there is such activity that has not been communicated, please submit a separate report under separate cover.
11. ☐ ☒ The local unit is free of repeated comments from previous years.
12. ☒ ☐ The audit opinion is UNQUALIFIED.
13. ☒ ☐ The local unit has complied with GASB 34 or GASB 34 as modified by MCGAA Statement #7 and other generally accepted accounting principles (GAAP).
14. ☒ ☐ The board or council approves all invoices prior to payment as required by charter or statute.
15. ☒ ☐ To our knowledge, bank reconciliations that were reviewed were performed timely.

If a local unit of government (authorities and commissions included) is operating within the boundaries of the audited entity and is not included in this or any other audit report, nor do they obtain a stand-alone audit, please enclose the name(s), address(es), and a description(s) of the authority and/or commission.

I, the undersigned, certify that this statement is complete and accurate in all respects.

We have enclosed the following:	Enclosed	Not Required (enter a brief justification)		
Financial Statements	<input checked="" type="checkbox"/>			
The letter of Comments and Recommendations	<input checked="" type="checkbox"/>			
Other (Describe)	<input type="checkbox"/>	N/A		
Certified Public Accountant (Firm Name) The Rehmann Group		Telephone Number (517) 787-6503		
Street Address 675 Robinson Road		City Jackson	State MI	Zip 49203
Authorizing CPA Signature 		Printed Name Stephen W. Blann, CPA, CGFM		License Number 24801

Village of Three Oaks

Berrien County, Michigan

FINANCIAL STATEMENTS

**For the Year Ended
February 28, 2006**



REHMANN ROBSON

Certified Public Accountants

VILLAGE OF THREE OAKS, MICHIGAN
For the Fiscal Year Ended February 28, 2006

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REHMANN ROBSON

Certified Public Accountants

A member of **THE REHMANN GROUP**



INDEPENDENT AUDITORS' REPORT

May 4, 2006

Members of the Village Council
Village of Three Oaks
Three Oaks, Michigan

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the ***Village of Three Oaks, Michigan***, as of and for the year ended February 28, 2006, which collectively comprise the Village's basic financial statements, as listed in the table of contents. These financial statements are the responsibility of the Village's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and aggregate remaining fund information of the Village of Three Oaks, Michigan, as of February 28, 2006, and the respective changes in financial position and cash flows, where applicable, thereof, and the budgetary comparisons for the general fund, for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The Village has elected not to present Management's Discussion and Analysis as required supplementary information. The GASB has determined that such information is necessary to supplement, although not required to be part of, the basic financial statements.

Our audit was conducted for the purpose of forming opinions on the financial statements that collective comprise the Village's basic financial statements. The supplementary information listed in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements of the Village of Three Oaks. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly presented in all material respects in relation to the basic financial statements taken as a whole.

A handwritten signature in black ink, reading "Lehmann Lobson". The signature is written in a cursive style with a large, stylized 'L' at the beginning.

BASIC FINANCIAL STATEMENTS

GOVERNMENT-WIDE FINANCIAL STATEMENTS

VILLAGE OF THREE OAKS, MICHIGAN
Statement of Net Assets
February 28, 2006

	Primary Government			Component Unit
	Governmental Activities	Business-type Activities	Total	
Assets				
Cash and cash equivalents	\$ 147,462	\$ 363,235	\$ 510,697	\$ 54,795
Receivables	62,675	83,171	145,846	80,227
Internal balances	25,438	(25,438)	-	-
Other assets	42,391	4,534	46,925	-
Capital assets not being depreciated	-	54,517	54,517	-
Capital assets being depreciated, net	425,703	6,165,580	6,591,283	-
 Total assets	 703,669	 6,645,599	 7,349,268	 135,022
 Liabilities				
Accounts payable and accrued expenses	48,044	47,044	95,088	21,525
Long-term liabilities:				
Due within one year	-	128,000	128,000	20,000
Due in more than one year	-	3,651,000	3,651,000	-
 Total liabilities	 48,044	 3,826,044	 3,874,088	 41,525
 Net Assets				
Invested in capital assets, net of related debt	425,703	2,441,097	2,866,800	-
Restricted for:				
Streets and highways	43,029	-	43,029	-
Unrestricted	186,893	378,458	565,351	93,497
 Total net assets	 <u>\$ 655,625</u>	 <u>\$ 2,819,555</u>	 <u>\$ 3,475,180</u>	 <u>\$ 93,497</u>

The accompanying notes are an integral part of these financial statements.

VILLAGE OF THREE OAKS, MICHIGAN
Statement of Activities
For the Year Ended February 28, 2006

Functions / Programs	Expenses	Program Revenues			Net (Expense) Revenue
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	
Primary government					
Governmental activities:					
Legislative	\$ 9,300	\$ -	\$ -	\$ -	\$ (9,300)
General government	145,246	7	-	-	(145,239)
Public safety	291,373	62,370	9,033	-	(219,970)
Public works	540,730	69,960	38,898	-	(431,872)
Planning and economic development	11,945	-	-	-	(11,945)
Parks and recreation	34,247	1,775	-	-	(32,472)
Interest on long-term debt	614	-	-	-	(614)
Total governmental activities	<u>1,033,455</u>	<u>134,112</u>	<u>47,931</u>	<u>-</u>	<u>(851,412)</u>
Business-type activities:					
Sewer	356,046	290,876	3,373	-	(61,797)
Water	<u>266,087</u>	<u>221,802</u>	<u>6,678</u>	<u>-</u>	<u>(37,607)</u>
Total business-type activities	<u>622,133</u>	<u>512,678</u>	<u>10,051</u>	<u>-</u>	<u>(99,404)</u>
Total primary government	<u>\$ 1,655,588</u>	<u>\$ 646,790</u>	<u>\$ 57,982</u>	<u>\$ -</u>	<u>\$ (950,816)</u>
Component unit					
Downtown Development Authority	\$ 420,043	\$ -	\$ 357,308	\$ -	\$ (62,735)

continued...

VILLAGE OF THREE OAKS, MICHIGAN
Statement of Activities (Concluded)
For the Year Ended February 28, 2006

	Primary Government			Component Unit
	Governmental Activities	Business-type Activities	Total	
Changes in net assets				
Net (expense) revenue	\$ (851,412)	\$ (99,404)	\$ (950,816)	\$ (62,735)
General revenues:				
Property taxes	396,359	-	396,359	116,136
State-shared revenues	192,368	-	192,368	-
Grants and contributions not restricted to particular programs	33,227	-	33,227	-
Unrestricted interest income	6,164	-	6,164	-
Total general revenues	628,118	-	628,118	116,136
Change in net assets	(223,294)	(99,404)	(322,698)	53,401
Net assets, beginning of year	878,919	2,918,959	3,797,878	40,096
Net assets, end of year	\$ 655,625	\$ 2,819,555	\$ 3,475,180	\$ 93,497

The accompanying notes are an integral part of these financial statements.

FUND FINANCIAL STATEMENTS

VILLAGE OF THREE OAKS, MICHIGAN

Balance Sheet

Governmental Funds

February 28, 2006

	<u>General</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
<u>ASSETS</u>			
Assets			
Cash and cash equivalents	\$ 123,213	\$ 24,249	\$ 147,462
Accounts receivable	10,449	-	10,449
Due from other governments	32,846	-	32,846
Due from other funds	209,256	40,787	250,043
Due from component unit	19,380	-	19,380
Prepaid items	42,391	-	42,391
	<u> </u>	<u> </u>	<u> </u>
<u>TOTAL ASSETS</u>	<u>\$ 437,535</u>	<u>\$ 65,036</u>	<u>\$ 502,571</u>
 <u>LIABILITIES AND FUND BALANCES</u>			
Liabilities			
Accounts payable	\$ 35,712	\$ -	\$ 35,712
Accrued liabilities	11,750	582	12,332
Due to other funds	40,787	183,818	224,605
	<u> </u>	<u> </u>	<u> </u>
Total liabilities	<u>88,249</u>	<u>184,400</u>	<u>272,649</u>
 Fund balances			
Reserved for:			
Prepaid items	42,391	-	42,391
Unreserved:			
Undesignated	306,895	-	306,895
Undesignated (deficit), reported in nonmajor special revenue funds	<u>-</u>	<u>(119,364)</u>	<u>(119,364)</u>
Total fund balances	<u>349,286</u>	<u>(119,364)</u>	<u>229,922</u>
 <u>TOTAL LIABILITIES AND FUND BALANCES</u>	 <u>\$ 437,535</u>	 <u>\$ 65,036</u>	 <u>\$ 502,571</u>

The accompanying notes are an integral part of these financial statements.

VILLAGE OF THREE OAKS, MICHIGAN
Reconciliation of Fund Balances on the Balance Sheet
for Governmental Funds to Net Assets of
Governmental Activities on the Statement of Net Assets
February 28, 2006

Fund balances - total governmental funds	\$ 229,922
Amounts reported for <i>governmental activities</i> in the statement of net assets are different because:	
Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds.	
Add - capital assets being depreciated	1,154,337
Deduct - accumulated depreciation	<u>(728,634)</u>
Net assets of governmental activities	<u><u>\$ 655,625</u></u>

The accompanying notes are an integral part of these financial statements.

VILLAGE OF THREE OAKS, MICHIGAN
Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds
For the Year Ended February 28, 2006

	General	Other Governmental Funds	Total Governmental Funds
Revenues			
Property taxes	\$ 396,359	\$ -	\$ 396,359
Licenses and permits	89,271	-	89,271
Intergovernmental	201,401	38,186	239,587
Police charges	51,781	-	51,781
Parks revenue	1,775	-	1,775
Interest revenue	6,164	712	6,876
Other revenues	24,512	-	24,512
	<u>771,263</u>	<u>38,898</u>	<u>810,161</u>
Expenditures			
Current:			
Legislative	9,300	-	9,300
General government	134,093	-	134,093
Public safety	278,949	-	278,949
Public works	291,910	227,706	519,616
Planning and economic development	7,112	-	7,112
Parks and recreation	22,860	-	22,860
Debt service:			
Principal	19,709	-	19,709
Interest and fiscal charges	998	-	998
Capital outlay	15,511	-	15,511
	<u>780,442</u>	<u>227,706</u>	<u>1,008,148</u>
Revenues under expenditures	<u>(9,179)</u>	<u>(188,808)</u>	<u>(197,987)</u>
Other financing sources (uses)			
Transfers in	-	36,545	36,545
Transfers out	(26,415)	(10,130)	(36,545)
Total other financing sources (uses)	<u>(26,415)</u>	<u>26,415</u>	<u>-</u>
Net changes in fund balances	(35,594)	(162,393)	(197,987)
Fund balances, beginning of year	<u>384,880</u>	<u>43,029</u>	<u>427,909</u>
Fund balances (deficit), end of year	<u><u>\$ 349,286</u></u>	<u><u>\$ (119,364)</u></u>	<u><u>\$ 229,922</u></u>

The accompanying notes are an integral part of these financial statements.

VILLAGE OF THREE OAKS, MICHIGAN
Reconciliation of the Statement of Revenues, Expenditures
and Changes in Fund Balances of Governmental Funds
to the Statement of Activities
For the Year Ended February 28, 2006

Net change in fund balances - total governmental funds	\$ (197,987)
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Amounts reported for *governmental activities* in the statement of activities are different because:

Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense.

Add - capital outlay	14,184
Deduct - depreciation expense	(59,584)

Bond proceeds provide current financial resources to governmental funds in the period issued, but issuing bonds increases long-term liabilities in the statement of net assets. Repayment of bond principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets.

Add - principal payments on long-term liabilities	19,709
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Some expenses reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in the funds.

Add - decrease in accrued interest payable on bonds	<u>384</u>
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Change in net assets of governmental activities	<u><u>\$ (223,294)</u></u>
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The accompanying notes are an integral part of these financial statements.

VILLAGE OF THREE OAKS, MICHIGAN
Statement of Revenues, Expenditures and Changes
in Fund Balance - Budget and Actual
General Fund
For the Year Ended February 28, 2006

	<u>Original/ Final Budget</u>	<u>Actual</u>	<u>Actual Over (Under) Final Budget</u>
Revenues			
Property taxes	\$ 419,000	\$ 396,359	\$ (22,641)
Licenses and permits	85,300	89,271	3,971
Intergovernmental	200,000	201,401	1,401
Police charges	48,000	51,781	3,781
Parks revenue	-	1,775	1,775
Interest revenue	5,500	6,164	664
Other revenues	71,000	24,512	(46,488)
	<u>828,800</u>	<u>771,263</u>	<u>(57,537)</u>
Total revenues			
Expenditures			
Legislative	9,300	9,300	-
	<u>9,300</u>	<u>9,300</u>	<u>-</u>
General government:			
Clerk	31,930	34,824	2,894
Elections	-	382	382
Treasurer	14,450	16,925	2,475
Other	96,315	81,962	(14,353)
Total general government	<u>142,695</u>	<u>134,093</u>	<u>(8,602)</u>
Public safety:			
Police	226,999	266,373	39,374
Fire	35,000	10,300	(24,700)
Building Inspection	13,950	2,276	(11,674)
Total public safety	<u>275,949</u>	<u>278,949</u>	<u>3,000</u>
Public works:			
Streets	<u>285,320</u>	<u>291,910</u>	<u>6,590</u>

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VILLAGE OF THREE OAKS, MICHIGAN
Statement of Revenues, Expenditures and Changes
in Fund Balance - Budget and Actual (Concluded)
General Fund
For the Year Ended February 28, 2006

	<u>Original/ Final Budget</u>	<u>Actual</u>	<u>Actual Over (Under) Final Budget</u>
Expenditures (Concluded)			
Planning and economic development:			
Planning	\$ 5,500	\$ 5,787	\$ 287
Economic development	7,500	1,325	(6,175)
Total planning and economic development	<u>13,000</u>	<u>7,112</u>	<u>(5,888)</u>
 Parks and recreation	 <u>28,850</u>	 <u>22,860</u>	 <u>(5,990)</u>
 Debt service:			
Principal	20,000	19,709	(291)
Interest and fiscal charges	<u>3,160</u>	<u>998</u>	<u>(2,162)</u>
Total debt service	<u>23,160</u>	<u>20,707</u>	<u>(2,453)</u>
 Capital outlay	 <u>55,500</u>	 <u>15,511</u>	 <u>(39,989)</u>
 Total expenditures	 <u>833,774</u>	 <u>780,442</u>	 <u>(53,332)</u>
 Revenues under expenditures	 (4,974)	 (9,179)	 (4,205)
 Other financing sources (uses)			
Transfers out	<u>(15,000)</u>	<u>(26,415)</u>	<u>(11,415)</u>
 Net changes in fund balance	 (19,974)	 (35,594)	 (15,620)
 Fund balance, beginning of year	 <u>384,880</u>	 <u>384,880</u>	 <u>-</u>
 Fund balance, end of year	 <u><u>\$ 364,906</u></u>	 <u><u>\$ 349,286</u></u>	 <u><u>\$ (15,620)</u></u>

The accompanying notes are an integral part of these financial statements.

VILLAGE OF THREE OAKS, MICHIGAN
Statement of Net Assets
Proprietary Funds
February 28, 2006

	Business-type Activities - Enterprise Funds		
	Sewer	Water	Total
Assets			
Current assets:			
Cash and cash equivalents	\$ 201,441	\$ 161,794	\$ 363,235
Accounts receivable	53,960	29,211	83,171
Due from other funds	-	908	908
Inventory, at cost	3,255	1,279	4,534
Total current assets	<u>258,656</u>	<u>193,192</u>	<u>451,848</u>
Noncurrent assets:			
Capital assets not being depreciated	30,017	24,500	54,517
Capital assets being depreciated, net	5,398,566	767,014	6,165,580
Total noncurrent assets	<u>5,428,583</u>	<u>791,514</u>	<u>6,220,097</u>
Total assets	<u>5,687,239</u>	<u>984,706</u>	<u>6,671,945</u>
Liabilities			
Current liabilities:			
Accrued liabilities	766	1,752	2,518
Due to other funds	7,806	18,540	26,346
Accrued interest payable	36,375	8,151	44,526
Current portion of long-term debt	103,000	25,000	128,000
Total current liabilities	<u>147,947</u>	<u>53,443</u>	<u>201,390</u>
Long-term debt, net of current portion	<u>2,901,000</u>	<u>750,000</u>	<u>3,651,000</u>
Total liabilities	<u>3,048,947</u>	<u>803,443</u>	<u>3,852,390</u>
Net Assets			
Invested in capital assets, net of related debt	2,424,583	16,514	2,441,097
Unrestricted	213,709	164,749	378,458
Total net assets	<u>\$ 2,638,292</u>	<u>\$ 181,263</u>	<u>\$ 2,819,555</u>

The accompanying notes are an integral part of these financial statements.

VILLAGE OF THREE OAKS, MICHIGAN
Statement of Revenues, Expenses
and Changes in Fund Net Assets
Proprietary Funds
For the Year Ended February 28, 2006

	<u>Business-type Activities - Enterprise Funds</u>		
	<u>Sewer</u>	<u>Water</u>	<u>Total</u>
Operating revenues			
Charges for services	<u>\$ 290,876</u>	<u>\$ 221,802</u>	<u>\$ 512,678</u>
Operating expenses			
Operation and maintenance	77,952	175,569	253,521
Depreciation	<u>180,536</u>	<u>41,150</u>	<u>221,686</u>
Total operating expenses	<u>258,488</u>	<u>216,719</u>	<u>475,207</u>
Operating income	<u>32,388</u>	<u>5,083</u>	<u>37,471</u>
Non-operating revenues (expenses)			
Investment income	3,373	3,367	6,740
Interest expense	(97,558)	(49,368)	(146,926)
Other non-operating revenue	<u>-</u>	<u>3,311</u>	<u>3,311</u>
Total non-operating expenses	<u>(94,185)</u>	<u>(42,690)</u>	<u>(136,875)</u>
Change in net assets	(61,797)	(37,607)	(99,404)
Net assets, beginning of year	<u>2,700,089</u>	<u>218,870</u>	<u>2,918,959</u>
Net assets, end of year	<u><u>\$ 2,638,292</u></u>	<u><u>\$ 181,263</u></u>	<u><u>\$ 2,819,555</u></u>

The accompanying notes are an integral part of these financial statements.

VILLAGE OF THREE OAKS, MICHIGAN
Statement of Cash Flows
Proprietary Funds
For the Year Ended February 28, 2006

	Business-type Activities - Enterprise Funds		
	Sewer	Water	Total
Cash flows from operating activities			
Cash received from customers	\$ 285,624	\$ 232,629	\$ 518,253
Cash payments to employees	(26,106)	(82,393)	(108,499)
Cash payments to suppliers for goods and services	(63,356)	(88,581)	(151,937)
Net cash provided by operating activities	196,162	61,655	257,817
Cash flows from non-capital financing activities			
Other receipts	-	3,311	3,311
Cash flows from capital and related financing activities			
Bond principal payments	(102,000)	(25,000)	(127,000)
Bond interest payments	(97,558)	(49,368)	(146,926)
Net cash used by capital and related financing activities	(199,558)	(74,368)	(273,926)
Cash flows from investing activities			
Investment income	3,373	3,367	6,740
Net decrease in cash and cash equivalents	(23)	(6,035)	(6,058)
Cash and cash equivalents, beginning of year	201,464	167,829	369,293
Cash and cash equivalents, end of year	<u>\$ 201,441</u>	<u>\$ 161,794</u>	<u>\$ 363,235</u>

continued...

VILLAGE OF THREE OAKS, MICHIGAN
Statement of Cash Flows (Concluded)
Proprietary Funds
For the Year Ended February 28, 2006

	<u>Business-type Activities - Enterprise Funds</u>		
	<u>Sewer</u>	<u>Water</u>	<u>Total</u>
Reconciliation of operating income to net cash provided by operating activities			
Operating income	\$ 32,388	\$ 5,083	\$ 37,471
Adjustments to reconcile operating income to net cash provided by operating activities:			
Depreciation	180,536	41,150	221,686
Changes in assets and liabilities:			
Accounts receivable	(5,252)	10,687	5,435
Accrued interest receivable	-	140	140
Accrued liabilities	638	1,512	2,150
Due to other funds	(11,031)	3,318	(7,713)
Accrued interest payable	(1,117)	(235)	(1,352)
Net cash provided by operating activities	<u>\$ 196,162</u>	<u>\$ 61,655</u>	<u>\$ 257,817</u>

The accompanying notes are an integral part of these financial statements.

VILLAGE OF THREE OAKS, MICHIGAN
Statement of Fiduciary Net Assets
Fiduciary Fund
February 28, 2006

	Tax Collections Agency Fund
	<hr/>
Assets	
Cash and cash equivalents	\$ 725
	<hr/>
Liabilities	
Due to other governments	\$ 725
	<hr/>

The accompanying notes are an integral part of these financial statements.

NOTES to the FINANCIAL STATEMENTS

VILLAGE OF THREE OAKS

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Notes to the Financial Statements

For the Year Ended February 28, 2006

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VILLAGE OF THREE OAKS

Notes To Financial Statements

I. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

In accordance with the provisions of the Governmental Accounting Standards Board's Statement No. 14, *The Financial Reporting Entity*, these financial statements present the government and its component unit, an entity for which the government is considered to be financially accountable. The discretely presented component unit is reported in a separate column in the government-wide financial statements to emphasize it is legally separate from the government. The discretely presented component unit has a February 28 year end.

Discretely Presented Component Unit (Downtown Development Authority) - The Downtown Development Authority was created as a tax-increment financing district to correct and prevent deterioration in the downtown district, encourage historical preservation and to promote economic growth within the downtown district. The Authority is governed by a five member board, selected by the Village Council. Furthermore, the Authority's budget is subject to approval by the Village Council.

B. Government-wide and fund financial statements

The government-wide financial statements (i.e., the statement of net assets and the statement of activities) report information on all of the nonfiduciary activities of the primary government and its component unit. For the most part, the effect of interfund activity has been removed from these statements. *Governmental activities*, which normally are supported by taxes and intergovernmental revenues, are reported separately from *business-type activities*, which rely to a significant extent on fees and charges for support. Likewise, the primary government is reported separately from the legally separate component unit for which the primary government is financially accountable.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. *Direct expenses* are those that are clearly identifiable with a specific function or segment. *Program revenues* include (1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and (2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as *general revenues*.

Separate financial statements are provided for governmental funds and proprietary funds. Major individual governmental funds and major individual enterprise funds are reported as separate columns in the fund financial statements.

VILLAGE OF THREE OAKS

Notes To Financial Statements

C. Measurement focus, basis of accounting, and financial statement presentation

The government-wide financial statements are reported using the *economic resources measurement focus* and the *accrual basis of accounting*, as are the proprietary fund financial statements. Agency funds also use the accrual basis of accounting but do not have a measurement focus. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements are reported using the *current financial resources measurement focus* and the *modified accrual basis of accounting*. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be *available* when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the government considers revenues to be available if they are collected within 60 days of the end of the current fiscal period, or within one year for expenditure-driven grants. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

Property taxes, franchise taxes, licenses, and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. Only the portion of special assessments receivable due within the current fiscal period is considered to be susceptible to accrual as revenue of the current period. Intergovernmental revenues are accrued when earned. All other revenue items are considered to be measurable and available only when cash is received by the government.

The Village reports the following major governmental funds:

The *general fund* is the Village's primary operating fund. It accounts for all financial resources of the general government, except those required to be accounted for in another fund.

The Village reports the following major proprietary funds:

The *sewer fund* accounts for the activities of the Village's sewer system.

The *water fund* accounts for the activities of the Village's water distribution and treatment system.

VILLAGE OF THREE OAKS

Notes To Financial Statements

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in both the government-wide and proprietary fund financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. Governments also have the *option* of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to this same limitation. The Village has elected not to follow subsequent private-sector guidance.

Proprietary funds distinguish *operating* revenues and expenses from *non-operating* items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the enterprise funds are charges to customers for sales and services. The enterprise funds also recognize as operating revenues the portion of tap fees intended to recover the cost of connecting new customers to the water and sewer system. Operating expenses for enterprise funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

When both restricted and unrestricted resources are available for use, it is the government's policy to use restricted resources first, then unrestricted resources as they are needed.

D. Assets, liabilities and equity

1. *Deposits and investments*

The Village's cash and cash equivalents are considered to be cash on hand, demand deposits and short-term investments with original maturities of three months or less from the date of acquisition.

State statutes authorize the Village to deposit in the accounts of federally insured banks, credit unions and savings and loan associations and to invest in obligations of the U.S. Treasury, certain commercial paper, repurchase agreements, bankers acceptances, and mutual funds composed of otherwise legal investments. The Village's investment policy allows for all of these types of investments.

2. *Interfund receivables and payables*

Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" (i.e., the current portion of interfund loans) or "advances to/from other funds" (i.e., the non-current portion of interfund loans). All other outstanding balances between funds are reported as "due to/from other funds." Any residual balances outstanding between the governmental activities and business-type activities are reported in the government-wide financial statements as "internal balances."

VILLAGE OF THREE OAKS

Notes To Financial Statements

3. *Inventories and Prepaid Items*

All inventories are valued at cost using the first-in/first-out (FIFO) method.

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items in both government-wide and fund financial statements.

4. *Capital assets*

Capital assets, which include property, plant, equipment, and infrastructure assets (e.g., roads, bridges, sidewalks, and similar items constructed or acquired after 1980), are reported in the applicable governmental or business-type activities columns in the government-wide financial statements. Capital assets are defined by the government as assets with an initial, individual cost of more than \$5,000 and an estimated useful life in excess of two years. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair value at the date of donation.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets of business-type activities, if any, is included as part of the capitalized value of the assets constructed. No such interest expense was incurred during the current fiscal year.

Capital assets of the primary government are depreciated using the straight-line method over the following estimated useful lives:

<u>Assets</u>	<u>Years</u>
Land improvements	30-40
Buildings and improvements	15-40
Furniture and Equipment	5-15
Vehicles	5-10
Water and Sewer Systems	20-50

5. *Compensated absences*

Village employees are not permitted to accumulate sick or vacation days to be carried over from year to year. Accordingly, no liability for compensated absences is recorded in these financial statements.

VILLAGE OF THREE OAKS

Notes To Financial Statements

6. *Long-term obligations*

In the government-wide financial statements, and proprietary fund types in the fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities, or proprietary fund type statement of net assets. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

7. *Fund equity*

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balance represent tentative management plans that are subject to change. There were no designations at year end.

II. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

A. **Budgetary information**

Annual budgets are adopted on a basis consistent with generally accepted accounting principles for the general and special revenue funds. All annual appropriations lapse at fiscal year end.

The appropriated budget is prepared by fund and function. The legal level of budgetary control is the functional level. Transfers of appropriations between functions require the approval of the Village Council. There were no amendments made to the budget during the current fiscal year.

B. **Deficit fund balance**

As of February 28, 2006, the local streets fund had a deficit fund balance of \$119,364 due to the State of Michigan temporarily freezing the Village's Act 51 intergovernmental revenue payments, pending receipt of audited financial statements from the Village. Management expects to eliminate this deficit through the subsequent receipt of said funding from the State.

VILLAGE OF THREE OAKS

Notes To Financial Statements

B. Excess of expenditures over appropriations

For the year ended February 28, 2006, expenditures exceeded appropriations as follows:

	<u>Original/ Final Budget</u>	<u>Actual</u>	<u>Over Budget</u>
General government	\$ 142,695	\$ 264,718	\$ 122,023
Public safety	275,949	278,949	3,000
Public works	285,320	291,910	6,590

III. DETAILED NOTES ON ALL FUNDS

A. Deposits and investments

Following is a reconciliation of deposit and investment balances as of February 28, 2006:

Statement of Net Assets

Cash and cash equivalents:

Governmental activities	\$ 147,462
Business-type activities	363,235
Component unit	54,795

Statement of Fiduciary Net Assets

Cash and cash equivalents:

Agency fund	<u>725</u>
-------------	------------

Total **\$ 566,217**

Deposits and investments

Bank deposits:

Checking/savings accounts	\$ 492,071
Certificates of deposit (due within one year)	73,946
Cash on hand	<u>200</u>

Total **\$ 566,217**

Deposit and investment risk

Interest Rate Risk. State law limits the allowable investments and the maturities of some of the allowable investments as identified in list of authorized investments in the accounting policies. The Village's investment policy does not have specific limits in excess of state law on investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates. All of the Village's deposits with fixed maturity dates (certificates of deposit) were due within one year.

VILLAGE OF THREE OAKS

Notes To Financial Statements

Credit Risk. State law limits investments to specific government securities, certificates of deposits and bank accounts with qualified financial institutions, commercial paper with specific maximum maturities and ratings when purchased, bankers acceptances of specific financial institutions, qualified mutual funds and qualified external investment pools as identified in the list of authorized investments in the accounting policies. The Village's investment policy does not have specific limits in excess of state law on investment credit risk. At year end, the Village had no investments, and was therefore not exposed to credit risk.

Custodial Credit Risk – Deposits. Custodial credit risk is the risk that in the event of a bank failure, the Village's deposits may not be returned. State law does not require and the Village does not have a policy for deposit custodial credit risk. As of year end, \$265,830 of the Village's bank balance of \$440,550 was exposed to custodial credit risk because it was uninsured and uncollateralized.

Concentration of Credit Risk. State law limits allowable investments but does not limit concentration of credit risk as identified in the list of authorized investments in the accounting policies. The Village's investment policy does not have specific limits in excess of state law on concentration of credit risk. At year end, the Village had no investments, and was therefore not exposed to concentration risk.

B. Receivables

Receivables as of year end are comprised of the following:

	<u>Governmental</u> <u>Activities</u>	<u>Business-type</u> <u>Activities</u>	<u>Component</u> <u>Unit</u>
Taxes receivable	\$ -	\$ -	\$ 80,227
Accounts receivable	10,449	83,171	-
Due from other governments	32,846	-	-
Due from component unit	<u>19,380</u>	<u>-</u>	<u>-</u>
Total	<u>\$ 62,675</u>	<u>\$ 83,171</u>	<u>\$ 80,227</u>

VILLAGE OF THREE OAKS

Notes To Financial Statements

C. Capital assets

Capital assets activity for the year ended February 28, 2006 was as follows:

	Beginning Balance	Additions	Disposals	Ending Balance
Governmental activities				
Capital assets, being depreciated:				
Land improvements	\$ 47,086	\$ -	\$ -	\$ 47,086
Buildings and improvements	397,261	-	-	397,261
Furniture and equipment	492,812	14,184	-	506,996
Vehicles	202,994	-	-	202,994
Total capital assets being depreciated	1,140,153	14,184	-	1,154,337
Less accumulated depreciation for:				
Land improvements	(6,696)	(1,233)	-	(7,929)
Buildings and improvements	(117,198)	(16,951)	-	(134,149)
Furniture and equipment	(387,629)	(29,256)	-	(416,885)
Vehicles	(157,527)	(12,144)	-	(169,671)
Total accumulated depreciation	(669,050)	(59,584)	-	(728,634)
Total capital assets being depreciated, net	471,103	(45,400)	-	425,703
Capital assets, net	\$ 471,103	\$ (45,400)	\$ -	\$ 425,703
	Beginning Balance	Additions	Disposals	Ending Balance
Business-type activities				
Capital assets, not being depreciated:				
Land	\$ 54,517	\$ -	\$ -	\$ 54,517
Capital assets, being depreciated:				
Equipment	212,196	-	-	212,196
Infrastructure	8,525,349	-	-	8,525,349
Total capital assets being depreciated	8,737,545	-	-	8,737,545
Less accumulated depreciation for:				
Equipment	(148,294)	(14,137)	-	(162,431)
Infrastructure	(2,201,986)	(207,548)	-	(2,409,534)
Total accumulated depreciation	(2,350,280)	(221,685)	-	(2,350,280)
Total capital assets being depreciated, net	6,387,265	(221,685)	-	6,165,580
Capital assets, net	\$ 6,441,782	\$ (221,685)	\$ -	\$ 6,220,097

VILLAGE OF THREE OAKS

Notes To Financial Statements

Depreciation expense was charged to functions/programs of the primary government as follows:

Governmental Activities:

General government	\$ 9,826
Public safety	12,424
Public works	21,114
Planning and economic development	4,833
Parks and recreation	<u>11,387</u>

**Total depreciation expense –
governmental activities**

\$ 59,584

Business-type Activities:

Sewer	\$ 180,535
Water	<u>41,150</u>

**Total depreciation expense –
business-type activities**

\$ 221,685

D. Accounts payable and accrued liabilities

Payables as of year end are comprised of the following:

	Governmental Activities	Business-type Activities	Finuciary Funds	Component Unit
Accounts payable	\$ 35,712	\$ -	\$ -	\$ -
Accrued liabilities	12,332	2,518	-	-
Accrued interest payable	-	44,526	-	2,145
Undistributed receipts	-	-	725	-
Due to primary government	<u>-</u>	<u>-</u>	<u>-</u>	<u>19,380</u>
Total	<u>\$ 48,044</u>	<u>\$ 47,044</u>	<u>\$ 725</u>	<u>\$ 21,525</u>

VILLAGE OF THREE OAKS

Notes To Financial Statements

E. Interfund receivables, payables and transfers

	Due From				
	General Fund	Nonmajor Governmental	Sewer	Water	Total
Due to:					
General Fund	\$ -	\$ 40,787	\$ -	\$ -	\$ 40,787
Nonmajor governmental	183,818	-	-	-	183,818
Sewer	6,898	-	-	908	7,806
Water	18,540	-	-	-	18,540
	\$ 209,256	\$ 40,787	\$ -	\$ 908	\$ 250,951

These balances resulted from the time lag between the dates that (1) interfund goods and services are provided or reimbursable expenditures occur, (2) transactions are recorded in the accounting system, and (3) payments between funds are made.

For the year ended February 28, 2006, interfund transfers consisted of the following:

	Transfer From		
	General fund	Nonmajor Governmental	Total
Transfer to:			
Nonmajor governmental	\$ 26,415	\$ 10,130	\$ 36,545

Transfers are used to: (1) move revenues from the fund that is required to collect them to the fund that is required or allowed to expend them; (2) move receipts restricted to or allowed for debt service from the funds collecting the receipts to the debt service fund as debt service payments become due; and (3) use unrestricted revenues collected in the general fund to finance various programs accounted for in other funds in accordance with budgetary authorizations.

VILLAGE OF THREE OAKS

Notes To Financial Statements

F. Long-term debt

Long-term debt at February 28, 2006, is comprised of the following.

Governmental activities

2003 International Model 7400 Dump Truck installment purchase contract, due in annual installments of \$20,547, including interest at 4.25%, through 2006.

	Beginning Balance	Additions	Reductions	Ending Balance	Due within one year
Governmental activities					
2003 International Model 7400 Dump Truck installment purchase contract	\$ 19,709	\$ -	\$ 19,709	\$ -	\$ -

Business-type activities

2001 Sanitary Sewer Clean Water Program Loan (through the Michigan Municipal Bond Authority), maturing serially through 2023 in annual amounts ranging from \$90,000-\$135,000, plus interest at 2.5%.

2001 Sanitary Sewer System Revenue Bonds, maturing serially through 2042 in annual amounts ranging from \$12,000-\$63,000, plus interest at 4.5%.

1978 Water Supply System Revenue Bonds, maturing serially through 2016 in annual amounts of \$15,000, plus interest at 5.0%.

1992 Water Treatment Plant, maturing serially through 2032 in annual amounts ranging from \$10,000-\$50,000, plus interest at 6.625%.

	Beginning Balance	Additions	Reductions	Ending Balance	Due within one year
Business-type activities					
2001 Sanitary Sewer Clean Water Program Loan	\$ 1,985,000	\$ -	\$ 90,000	\$ 1,895,000	\$ 90,000
Less: amount available to draw	(5,036)	5,036	-	-	-
2001 Sanitary Sewer System Revenue Bonds	1,121,000	-	12,000	1,109,000	13,000
1978 Water Supply System Revenue Bonds	165,000	-	15,000	150,000	15,000
1992 Water Treatment Plant	635,000	-	10,000	625,000	10,000
Total business-type activities	\$ 3,900,964	\$ 5,036	\$ 127,000	\$ 3,779,000	\$ 128,000

VILLAGE OF THREE OAKS

Notes To Financial Statements

The annual requirements to service business-type activities debt obligations as of February 28, 2006, are as follows:

Year Ended February 28	Business-Type Activities		
	Principal	Interest	Total
2007	\$ 128,000	\$ 144,063	\$ 272,063
2008	133,000	139,753	272,753
2009	134,000	135,358	269,358
2010	140,000	130,855	270,855
2011	140,000	126,268	266,268
2012-2016	777,000	555,724	1,332,724
2017-2021	825,000	423,297	1,248,297
2022-2026	546,000	289,862	835,862
2027-2031	369,000	192,188	561,188
2032-2036	261,000	99,554	360,554
2037-2041	263,000	44,798	307,798
2042-2042	63,000	1,418	64,418
	\$ 3,779,000	\$ 2,283,134	\$ 6,062,134

Component unit

Street Beautification Project limited tax general obligation bonds, maturing serially through 2007 in annual amounts of \$20,000, plus interest ranging from 7.10% - 7.15%.

	Beginning Balance	Additions	Reductions	Ending Balance	Due within one year
Component Unit					
Street Beautification Project LTGO Bonds	\$ 40,000	\$ -	\$ 20,000	\$ 20,000	\$ 20,000

The annual requirements to service component unit debt obligations as of February 28, 2006, are as follows:

Year Ended February 28	Component Unit		
	Principal	Interest	Total
2007	\$ 20,000	\$ 1,430	\$ 21,430

VILLAGE OF THREE OAKS

Notes To Financial Statements

G. Segment information-enterprise funds

The government issued revenue bonds to finance certain improvements to its water and sewer systems. Because the Sewer Fund and the Water Fund are each reported as major funds in the fund financial statements and account entirely for a specific segment, disclosures are not required herein.

IV. OTHER INFORMATION

A. Risk management

The Village is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. During the year ended February 28, 2006, the Village carried commercial insurance to cover all risks of losses. The Village has had no settled claims resulting from these risks that exceeded its commercial coverage in any of the past three fiscal years.

B. Property taxes

Village property tax revenues are recognized as revenues in the fiscal year levied to the extent that they are measurable and available. The Village bills and collects its own property taxes. Property taxes attach as an enforceable lien on property as of December 31. Village taxes are levied the following July 1 and are payable without penalty through September 15, at which time uncollected real property taxes are turned over to the County for reimbursement from their revolving tax fund. The Village continues to collect delinquent personal property taxes.

The State taxable value of all real and personal property on which Village tax levies were based for the year ended February 28, 2006, was \$31,567,864 and the millage rate was 13.4155 mills for general operations.

C. State Construction Code Act Compliance

Public Act 245 of 1999 amended the State Construction Act to require Michigan municipal governments to establish fees which bear a reasonable relationship to the cost of operating their building departments. The Village's fee structure is not intended to fully recover its costs, and accordingly, the operations of the Village's building department are accounted for in the General Fund.

VILLAGE OF THREE OAKS

Notes To Financial Statements

For the year ended February 28, 2006, the Village's revenue and expenditures related to its building department were as follows:

Revenue

Building permits	\$	(250)
Electrical permits		2,954
Mechanical permits		<u>870</u>
	\$	<u><u>3,574</u></u>

Expenditures

Building inspection	\$	<u><u>2,276</u></u>
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No reservation of fund balance was required as of February 28, 2006, due to the cumulative deficiency of revenue over expenditures from past fiscal years.

* * * * *

SUPPLEMENTARY INFORMATION

VILLAGE OF THREE OAKS, MICHIGAN
Combining Balance Sheet
Nonmajor Governmental Funds
February 28, 2006

	<u>Special Revenue Funds</u>		Total
	<u>Major</u>	<u>Local</u>	Nonmajor
	<u>Street</u>	<u>Street</u>	Governmental
			Funds
 <u>ASSETS</u>			
Cash and cash equivalents	\$ 19,255	\$ 4,994	\$ 24,249
Due from other funds	26,415	14,372	40,787
<u>TOTAL ASSETS</u>	<u>\$ 45,670</u>	<u>\$ 19,366</u>	<u>\$ 65,036</u>
 <u>LIABILITIES AND</u>			
<u>FUND BALANCES</u>			
 Liabilities			
Accured liabilities	\$ 299	\$ 283	\$ 582
Due to other funds	45,371	138,447	183,818
Total liabilities	45,670	138,730	184,400
 Fund Balances			
Unreserved, undesignated (deficit)	-	(119,364)	(119,364)
<u>TOTAL LIABILITIES</u>	<u>\$ 45,670</u>	<u>\$ 19,366</u>	<u>\$ 65,036</u>
<u>AND FUND BALANCES</u>			

VILLAGE OF THREE OAKS, MICHIGAN
Combining Statement of Revenues, Expenditures and Changes in Fund Balance
Nonmajor Governmental Funds
For the Year Ended February 28, 2006

	Special Revenue Funds		Total
	Major	Local	Nonmajor
	Street	Street	Governmental
			Funds
Revenues			
Intergovernmental	\$ 26,337	\$ 11,849	\$ 38,186
Interest revenue	522	190	712
Total revenues	26,859	12,039	38,898
Expenditures			
Public works	63,458	164,248	227,706
Revenues over (under) expenditures	(36,599)	(152,209)	(188,808)
Other financing sources (uses)			
Transfers in	26,415	10,130	36,545
Transfers out	(10,130)	-	(10,130)
Total other financing sources (uses)	16,285	10,130	26,415
Net changes in fund balances	(20,314)	(142,079)	(162,393)
Fund balances, beginning of year	20,314	22,715	43,029
Fund balances, end of year	\$ -	\$ (119,364)	\$ (119,364)

VILLAGE OF THREE OAKS, MICHIGAN
Statement of Net Assets and
Governmental Funds Balance Sheet
Downtown Development Authority Component Unit
February 28, 2006

	Debt Service Fund	Capital Projects Fund	Total	Adjustments	Statement of Net Assets
Assets					
Cash and cash equivalents	\$ 433	\$ 54,362	\$ 54,795	\$ -	\$ 54,795
Taxes receivable	-	80,227	80,227	-	80,227
Total assets	<u>\$ 433</u>	<u>\$ 134,589</u>	<u>\$ 135,022</u>	<u>-</u>	<u>135,022</u>
Liabilities					
Accrued interest payable	\$ -	\$ -	\$ -	2,145	2,145
Due to primary government	-	19,380	19,380	-	19,380
Long-term liabilities:					
Due within one year	-	-	-	20,000	20,000
Total liabilities	-	19,380	19,380	22,145	41,525
Fund balances					
Unreserved, undesignated	433	115,209	115,642	(115,642)	-
Total liabilities and fund balances	<u>\$ 433</u>	<u>\$ 134,589</u>	<u>\$ 135,022</u>		
Net assets, unrestricted				<u>\$ 93,497</u>	<u>\$ 93,497</u>

VILLAGE OF THREE OAKS, MICHIGAN
Statement of Activities and
Governmental Fund Revenues, Expenditures
and Changes in Fund Balance
Downtown Development Authority Component Unit
For the Year Ended February 28, 2006

	Debt Service Fund	Capital Projects Fund	Total	Adjustments	Statement of Activities
Expenditures/expenses					
Downtown development	\$ -	\$ 416,239	\$ 416,239	\$ 644	\$ 416,883
Debt service:					
Principal	20,000	-	20,000	(20,000)	-
Interest and fiscal charges	2,145	300	2,445	715	3,160
Capital outlay	-	644	644	(644)	-
	<u>22,145</u>	<u>417,183</u>	<u>439,328</u>	<u>(19,285)</u>	<u>420,043</u>
General revenues					
Property taxes	-	116,136	116,136	-	116,136
Intergovernmental	-	356,945	356,945	-	356,945
Investment earnings	9	354	363	-	363
	<u>9</u>	<u>473,435</u>	<u>473,444</u>	<u>-</u>	<u>473,444</u>
 Excess of general revenues over (under) expenditures/expenses	 <u>(22,136)</u>	 <u>56,252</u>	 <u>34,116</u>	 <u>19,285</u>	 <u>53,401</u>
Other financing sources (uses)					
Transfers in	22,145	-	22,145	(22,145)	-
Transfers out	-	(22,145)	(22,145)	22,145	-
	<u>22,145</u>	<u>(22,145)</u>	<u>-</u>	<u>-</u>	<u>-</u>
 Net changes in fund balances	 9	 34,107	 34,116	 (34,116)	 -
 Change in net assets	 -	 -	 -	 53,401	 53,401
Fund balance/net assets					
Beginning of year	<u>424</u>	<u>81,102</u>	<u>81,526</u>	<u>(41,430)</u>	<u>40,096</u>
End of year	<u>\$ 433</u>	<u>\$ 115,209</u>	<u>\$ 115,642</u>	<u>\$ (22,145)</u>	<u>\$ 93,497</u>



REHMANN ROBSON

Certified Public Accountants

A member of THE REHMANN GROUP



May 4, 2006

Members of the Village Council
Village of Three Oaks
Three Oaks, Michigan

We have audited the financial statements of the Village of Three Oaks for the year ended February 28, 2006, and have issued our report thereon dated May 4, 2006. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility Under Auditing Standards Generally Accepted in the United States of America

As stated in our engagement letter dated April 24, 2006, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement and are fairly presented in accordance with accounting principles generally accepted in the United States of America. Because an audit is designed to provide reasonable, but not absolute assurance and because we did not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us.

As part of our audit, we considered the internal control of the Village of Three Oaks. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

Significant Accounting Policies

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we advised management about the appropriateness of accounting policies and their application. The significant accounting policies used by the Village of Three Oaks are described in Note 1 to the financial statements.

We noted no transactions entered into by the Village of Three Oaks during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements were:

- Management's estimate of the useful lives of depreciable capital assets in the government-wide and enterprise fund financial statements is based on the length of time it is believed that those assets will provide some economic benefit in the future. We evaluated the key factors and assumptions used to develop the useful lives of those assets in determining that it is reasonable in relation to the financial statements taken as a whole.

Audit Adjustments

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the Village of Three Oaks's financial reporting process (that is, cause future financial statements to be materially misstated). As described in the accompanying memorandum, we proposed numerous material adjusting journal entries, which in our judgment, had a significant effect on the Village of Three Oaks's financial reporting process.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Issues Discussed Prior to Retention of Independent Auditors

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the Village's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Difficulties Encountered in Performing the Audit

We encountered no difficulties in dealing with management in performing our audit.

This letter and the accompanying memorandum are intended for the use of the Village Council, management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

A handwritten signature in black ink, reading "Lehmann Johnson". The signature is written in a cursive, flowing style with a large initial 'L'.

Village of Three Oaks

Comments and Recommendations

For the Year Ended February 28, 2006

During our audit we became aware of certain issues regarding internal control and financial reporting. This memorandum summarizes our comments and suggestions regarding these matters. This memorandum does not affect our report dated May 4, 2006 on the financial statements of the Village of Three Oaks.

Accounting Software

The Village currently uses “QuickBooks”, a small business accounting software package, to account for its financial operations. QuickBooks is not a governmental fund accounting package, and as such, is not well suited to the needs of governments. While it is technically possible to fully comply with governmental generally accepted accounting principles, state statutes, and other regulatory requirements using such a system, it requires a significant amount of manual intervention on the part of management to do so.

As in the management letter in the previous year, we recommend that management consider the possibility of upgrading its financial management system to a software package designed specifically for the governmental market. This would significantly enhance the Village’s ability to properly account for its operations and to comply with relevant regulations. We would be pleased to assist the Village in this process, if desired.

Internal Controls – Segregation of Duties

Management is responsible for establishing and maintaining effective internal control over financial reporting and the safeguarding of the Village’s assets. In establishing appropriate internal controls, careful consideration must be given to the cost of a particular control and the related benefits to be received. Accordingly, management must make the difficult decision of what degree of risk it is willing to accept, given the government’s unique circumstances.

As is the case with many organizations of similar size, the Village lacks a sufficient number of accounting personnel in order to ensure a complete segregation of duties within its accounting function. Ideally, no single individual should ever be able to authorize a transaction, record the transaction in the accounting records, and maintain custody of the assets resulting from the transaction. Effectively, proper segregation of duties is intended to prevent an individual from committing an act of fraud or abuse and being able to conceal it.

Events of recent years have given rise to a heightened awareness of the risks of fraud and abuse, especially in the governmental environment, where public accountability is at its highest. The purpose of internal controls is to provide reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are properly authorized and recorded. Any limitations on the effectiveness of a government’s internal controls carries with it a greater risk of fraud and abuse.

Village of Three Oaks

Comments and Recommendations

For the Year Ended February 28, 2006

As stated previously, the establishing and maintaining of internal controls is the responsibility of management. As the Village's independent external auditors, we are specifically banned by professional standards from performing any management functions. In other words, the annual audit is not a part of the Village's internal control structure, and cannot not be relied upon as part of *management's* systems to deter or detect fraud and abuse.

While there are, of course, no easy answers to the challenge of balancing the costs and benefits of internal controls and the segregation of duties, we would nevertheless encourage management to actively seek ways to further strengthen its internal control structure by requiring as much independent review, reconciliation, and approval of accounting functions by qualified members of management as possible.

Specific matters coming to our attention of which we believe the Village should be particularly aware include the following:

- *Bank reconciliations* – The Village does not currently have separate employees who initiate ACH wire transfers, prepare bank reconciliations and have access to the general ledger.
- *Key Financial Duties* – When staffing constraints require two or more key financial duties to be performed by a single individual, the Village does not require that the work be reviewed by a separate responsible official.
- *New Vendors* – The Village does not currently seek approval for new vendors from an individual not responsible for accounts payable.
- *Inventory* – The Village does not currently keep perpetual inventory records and adjustments to inventory balances are not reviewed or approved by a responsible official.
- *Capital Assets* – The Village does not currently inventory and monitor all capital assets that are susceptible to theft. Also the Village does not currently require an annual review of capital asset additions and deletions by individual departments or create updated depreciation schedules
- *Bond Proceeds* – When the Village receives bond proceeds there is not an appropriate official who oversees the use of the proceeds to ensure they are only spend on allowable costs and activities.
- *Journal Entries* – The Village does not currently have a policy to review or approve journal entries. The Village also does not reconcile the balance sheet accounts against supporting documentation and subsidiary ledgers or account for the journal entries sequentially with supporting documentation.